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No. 80-1614

In the Supreme Court of the United States

OCTOBER TERM, 1981

GEORGE F. JEWETT, JR.
and
LUCILLE M. JEWETT,
PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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I. THE COMMISSIONER'S ATTEMPTED REPHRASING DOES NOT RESOLVE THE INCONSISTENCY BETWEEN HIS ARGUMENT AND THE REGULATION'S PLAIN LANGUAGE.

The keystone of the Commissioner's interpretation of Treasury Regulation §25.2511-1(c) is his contention that "transfer...of ownership of a decedent's property" to the disclaimant means the *creation* of a contingent remainder interest under a trust rather than the actual *transfer* of the trust property upon the elimination of the contingency. As if to mask the inconsistency between his argument and the plain

meaning of the Regulation, discussed in Petitioners' Brief at 19, the Commissioner repeatedly and consistently rephrases the text of the Regulation to beg the issue. For example, at Resp. Br. 7 he states that the Regulation requires that the disclaimer be made "within a reasonable time after a person learns of his rights to the property"; at 14 he uses the identical language and then varies that language with "after the person becomes aware of his interest in the property"; at 15 it is "after he learned of the existence of his remainder" and "after petitioner learned of his remainder interest"; at 16 he uses three variations: "learns of his rights to the property", "learns of the existence of his interest" and "learns of his right to a property interest." *See also* Resp. Br. at 17, 18, 19.

The Commissioner's persistent rephrasing of the text calls for an equally persistent reminder that it is the language of the Regulation, not a colored paraphrase, which is at issue. Treasury Regulation §25.2511-1(c) requires a disclaimer to be made "within a reasonable time after knowledge of the existence of the *transfer*," (emphasis added) and the term "transfer" relates in context to "ownership of property transferred from a decedent" and to "a transfer...of ownership of a decedent's property." Knowledge of "the transfer" means just that—knowledge of a *transfer to the disclaimant of ownership*, not mere "knowledge of the existence of his interest" or "learning of his rights". *See* Pet. Br. at 19.

The Commissioner's careful choice of phrase cannot gloss over the fundamental conflict between his argument and the plain language of the Regulation.

II. Contrary to the Commissioner's Assertion, Jewett Exercised No Control Over the Subsequent Disposition of the Contingent Remainder.

In his statement of facts, the Commissioner erroneously states that Jewett "disclaimed his interest in the trust *in favor of his issue*" (Resp. Br. at 3) (Emphasis added). Later, he

refers to "the beneficiaries of his disclaimers" (*id.* at 23 n.8), suggesting that Jewett's disclaimers affirmatively directed his interest to certain "beneficiaries".

In fact, Jewett's disclaimers were silent as to the disposition of the remainder interest. (J. App. 15-18) Jewett did not direct the interest to his issue, to any particular beneficiaries or to anyone; he merely refused to accept a potential bequest. Jewett's disclaimers had precisely the same consequences under the trust as his death prior to the life beneficiary's would have.

Disposition of the trust property, upon the death of the last life beneficiary, depends upon the Testatrix's Will and applicable state law. Indeed the trust property may not go to Jewett's issue at all. Under the Will, the ultimate recipients could be Jewett's children, their issue, their uncles and aunts, their cousins, or various more distant relatives. (J. App. 9-11) Neither Jewett nor anyone else can determine those ultimate recipients until the death of the remaining life beneficiary. *See* Pet. Br. at 7 n.3.

III. The Commissioner's Analogy of Jewett's Disclaimers to the Exercise of a General Power of Appointment Is Inapt.

As Petitioner has argued (Pet. Br. at 22-23), if the exercise of a limited power of appointment is not a taxable transfer, then *a fortiori* a disclaimer, involving a lesser degree of control, should not be taxable. The Commissioner contends that this argument "falls wide of the mark", and that "[a] disclaimant's control over property more closely resembles a [taxable] general power of appointment," because a disclaimant, "unlike the holder of a special power of appointment, can decide to accept the property for himself, in the same manner as the holder of a general power" (Resp. Br. at 34).

It is the Commissioner's analogy which fails. Jewett's ability to accept the property for himself was *contingent*. It required him to survive his mother's death. Thus the Commissioner's analogy more accurately would be to a person who might in

the future have a general power of appointment, but only if he were to survive his mother. The release of such a contingent power would *not* be taxable. Internal Revenue Code §2041, 26 U.S.C. §2041.

IV. The Commissioner Misstates the Issue of Retroactivity.

The Commissioner argues that there is no problem of retroactivity in his interpretation of Treasury Regulation §25.2511-1 because Jewett disclaimed long after the promulgation of the Regulation and because in any event he never had a right to disclaim his remainder interest free of tax. (Resp. Br. at 35-36, 37-38). Those contentions are disingenuous.

The Commissioner agrees that section 25.2511-1(c) "applies to all gifts, including disclaimers treated as gifts, made after December 31, 1954." (Resp. Br. at 35). If the Commissioner's interpretation of the Regulation is valid, a disclaimer by Jewett on January 1, 1955 would have been taxable. Yet the law prior to the 1958 promulgation of the Regulation was clear: under *Brown* v. *Routzahn*, 63 F.2d 914 (6th Cir. 1933), *cert. denied*, 290 U.S. 641 (1933), Jewett could disclaim free of tax. This is not a case in which the Regulation filled a void in the preexisting law.[1] Rather the rule of *Brown* v. *Routzahn* was clear and unequivocal and the Commissioner's interpretation would have reversed that rule retroactively.

If the Commissioner's interpretation of the Regulation is correct, the Regulation worked a fundamental change in the law, retroactively, without warning and without a "grace period" within which holders of preexisting interests might disclaim.

To permit such an unannounced retroactive change would be fundamentally unfair. Rather than ascribe such an illogical and inequitable meaning to the Regulation, the Commissioner's interpretation should be rejected.

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[1] The Commissioner apparently ignores *Brown* v. *Routzahn*, *supra*, when he asserts that "the Regulation did not change settled law but became the first controlling rule, much like a definitive judicial decision." Resp. Br. 36 n.16.

V. Although Federal Tax Standards May Differ From State Standards There Is No Requirement That They Must Differ.

The Commissioner persists in misstating Jewett's position and the position of the Eighth Circuit in *Keinath* v. *Commissioner*, 480 F.2d 57 (8th Cir. 1973), and *Cottrell* v. *Commissioner*, 628 F.2d 1127 (8th Cir. 1980), by asserting that Jewett contends that the state rule for timeliness of disclaimer is controlling for purposes of the federal tax law. (Resp. Br. at 20-21, 26).

Petitioners do not contend that state law is controlling on the issue of timeliness. Petitioners, like the Eighth Circuit in *Keinath*, recognize that for federal tax purposes "we are not conclusively bound by the state law," but they also recognize that there *is* no federal law of disclaimer, and that therefore "state law . . . is the only field to probe for legal decisions and discussions on the phrase 'reasonable time' as used in the context of making valid disclaimers." 480 F.2d at 61-62.

Petitioners admit that federal tax law standards *can* differ from state law standards. However, the Commissioner appears to be arguing that because they *can* differ the federal standards *must* differ, a position which is neither logically compelling nor factually reasonable when there is no existing federal law of disclaimer and when all 34 states having statutes in point, and other states by decisional law, have expressly adopted the standard advanced by Petitioners and the Eighth Circuit (*see* Pet. Br. at 16-19).

VI. Jewett's Intent Is Irrelevant.

The Commissioner acknowledges that Jewett's intent in executing the disclaimers is irrelevant to this case. (Resp. Br. at 12). However, he repeatedly suggests, directly or by innuendo, that Jewett's intent in executing the disclaimers should color this Court's analysis of the law.

Hence, the Commissioner points out that Jewett's delay was "purposeful" (Resp. Br. at 15), that when he disclaimed Jewett was 45 years old, "an age that was actuarially beyond his mid-life" (*id.* at 18), that he "acted with some degree of caution and with seeming reluctance" (*id.*), that "he presumably had determined" that he did not need the remainder interest (*id.*), and that he "appears to be a person of substantial wealth" (*id.* at 18 n.5). The Commissioner quotes the Tax Court's gratuitous comment that the trust property would pass "to the natural objects of [Jewett's] bounty" (*id.* at 19) and he later adopts that comment as his own (*id.* at 32). Surely the Commissioner's position cannot be that the disclaimers would be tax free if Jewett had been ignorant of the law, or reckless, or impecunious, or poorly advised, or in his twenties, or estranged from the next contingent beneficiary.

Jewett's intent is irrelevant. The Commissioner's speculation as to Jewett's intent adds nothing to the resolution of this case.

VII. The IRS Technical Memorandum Dated October 1, 1958 Documents the Drafters' Intent To Codify Existing Law.

In their Brief Petitioners argued that Treasury Regulation §25.2511-1(c) was a codification of the existing common law of disclaimer as expounded particularly in two pre-1958 cases, *Brown* v. *Routzahn*, *supra*, and *Hardenbergh* v. *Commissioner*, 198 F.2d 63 (8th Cir. 1952), *cert. denied*, 344 U.S. 836 (1952). (*See* Pet. Br. at 12-16). That preexisting common law provided, generally, that a disclaimer valid and timely under state law would not be taxable as a gift unless under state law title immediately vested in the would-be disclaimant without an option of acceptance or rejection. *Id.*

Subsequent to the filing of Petitioners' Brief, an IRS Technical Memorandum was published which had been pre-

pared by the drafters of Treasury Regulation §25.2511.1 to explain to the Treasury Department the final version of that Regulation. Taxation with Representation Fund, XIII *Tax Notes*, 203 (July 27, 1981). (A copy of the Technical Memorandum, dated October 1, 1958, is attached hereto as Appendix A). That memorandum expressly describes the intent of the drafters of the Regulation at issue herein. It was called to this Court's attention by the Brief of an Amicus Curiae filed on behalf of the Estate of Helen W. Halbach, which had obtained the memorandum under the Freedom of Information Act. The Commissioner in his Brief dismissed the memorandum with one sentence at the end of a footnote (Resp. Br. at 25 n.10).[8] That memorandum, however, warrants more detailed attention.

The purpose of an IRS Technical Memorandum is to provide "a detailed explanation of the regulations" and it may "summarize the regulations, evaluate possible problems in interpreting the statute or prior regulations, provide background information, or explain the reasons for the approaches taken in specific provisions of the regulations." *Taxation With Representation Fund* v. *IRS*, 646 F.2d 666, 674 (D.C. Cir. 1981). Technical Memoranda "may tell more about a regulation than the regulation itself." *Id.* at 683.

In this case the Technical Memorandum states that Treasury Regulation §25.2511-1(c) was expressly intended to codify existing law as interpreted in *Brown* v. *Routzahn*, *supra*, and *Hardenbergh* v. *Commissioner*, *supra:*

> Paragraph (c) of section 25.2511-1, . . . discusses certain acts which constitute the making of a gift. Among the acts discussed is the renunciation, or attempted renunciation, of property, or a property interest, passing from a

[8] The Commissioner in fact later relied on the Memorandum in another footnote. (Resp. Br. at 27 n.11).

> decedent. *In what was intended to be the application of the rules in Brown* v. *Routzahn* (1933) 63 F.2d 914, *cert. denied* 290 U.S. 641, *and Hardenbergh* v. *Commissioner* (1952) 198 F.2d 63, *cert. denied* 344 U.S. 836, it was stated that where title to the property did not vest in the beneficiary or heir immediately upon the decedent's death, the renunciation of the property did not constitute the making of a gift, but that where title vested in the beneficiary or heir immediately upon the decedent's death, the act of the beneficiary or heir in giving up what passed to him from the decedent constituted the making of a gift. . . . Protests on these provisions were received. After reviewing these protests, we have reconsidered our position and now believe that the proper distinction between these two court cases turns on the question of whether under the applicable State law a beneficiary or heir can or cannot refuse to accept ownership of the property which passed from the decedent. Accordingly, we have revised paragraph (c) of Section 25.2511-1 to reflect this change of position. . . .

A-2–A-3 (emphasis added).

Agency memoranda contemporaneously interpreting or explaining the agency's own regulations are given substantial weight in the interpretation of ambiguous language in the regulations. *See Legal Aid Soc. of Alameda County* v. *Brennan*, 608 F.2d 1319, 1341 n.43 (9th Cir. 1979); *Charles* v. *Krauss Co., Ltd.*, 572 F.2d 544, 547-48 (5th Cir. 1978); *Phillips Petroleum Co.* v. *Department of Energy*, 449 F. Supp. 760, 784 (D. Del. 1978), *aff'd sub nom. Standard Oil Co.* v. *Department of Energy*, 596 F.2d 1029 (Em. App. 1978); *Borelli* v. *Reconstruction Finance Corp.*, 196 F.2d 730, 736-37 (Em. App. 1952). That is true even when the memorandum is not composed or written by the agency decisionmaker. "Courts consider contemporaneous expressions of opinion by low-ranking officials highly relevant and material evidence of

the general understanding of ambiguous regulatory provisions." *Phillips Petroleum Co.* v. *DOE, supra,* 449 F. Supp. at 784. IRS Technical Memoranda, moreover, are treated internally by the IRS as part of the IRS's own internal agency authority, and often are used as *de facto* substantive law by the employees of the IRS. *Taxation With Representation Fund* v. *IRS, supra,* 485 F. Supp. at 267.

The Petitioners do not contend that the Regulation is ambiguous. Rather, the Regulation, on its face, indicates that Jewett's disclaimers were not taxable. However, if this Court determines that the regulatory language is in any way ambiguous, the Technical Memorandum would resolve that ambiguity authoritatively. It represents the express contemporaneous understanding of the draftsmen, and it squarely supports the Petitioners' position.[3]

Conclusion

The judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on December 9, 1980 should be reversed and judgment entered for Petitioners.

Respectfully submitted,

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[3] Since the publication of the Technical Memorandum, secondary authorities have already noted that it severely undercuts the Commissioner's position in this case. *E.g.*, Research Institute of America, Inc., *Federal Tax Coordinator 2d*, 27 *Weekly Alert* 223 (July 30, 1981); Taxation with Representation Fund, XIII *Tax Notes* 203 (July 27, 1981).

APPENDIX

The following is a Memorandum dated October 1, 1958 as published in Taxation with Representation Fund, XIII *Tax Notes*, 203 (July 27, 1981).

October 1, 1958

MEMORANDUM FOR: Honorable Robert B. Anderson
Secretary of the Treasury

SUBJECT: Proposed Treasury decision—
Regulations under provisions of the Internal Revenue Code of 1954 relating to the gift tax.

[See T.D. 6334, 1958-2 C.B. 627]

There is transmitted herewith, with the recommendation that it be approved, a proposed Treasury decision which would issue the Gift Tax Regulations (26 CFR Part 25) under chapter 12 of subtitle B of the Internal Revenue Code of 1954. The regulations contained in the proposed Treasury decision are applicable to gifts made on or after January 1, 1955.

The proposed Treasury decision is substantially the same as that published as notice of proposed rule making in the Federal Register of January 3, 1957 (22 F.R. 53). In those areas where the Estate Tax Regulations and the Gift Tax regulations interpret similar provisions of law, the Gift Tax Regulations have been conformed to agree with the positions taken in the Estate Tax Regulations. Among the provisions of law pertaining to the estate tax and the gift tax which are similar are those relating to valuation of property, powers of appointment, charitable deductions, marital deductions, and certain administrative provisions relating to the time and place for filing returns and paying tax, the keeping of records, etc. In the case of the Estate Tax Regulations certain material

found in the notice of proposed rule making was removed from the final regulations because of doubt as to the accuracy of the material, and certain subjects were not treated (or, if treated at all, were referred to in general terms only) because of lack of agreement as to the precise rule to be followed. Where such material and subjects also come within the scope of the Gift Tax Regulations, the same action was taken as in the case of the Estate Tax Regulations. Among these subjects are transfers for less than full consideration (including property settlements and transfers for support which do not come under section 2516), and the valuation of shares in open-end investment companies. A few significant changes were made in the portions of the proposed regulations which pertain to subjects peculiar to the gift tax. These changes may be summarized as follows:

Disclaimers.

Paragraph (c) of section 25:2511-1, as set forth in the notice, discusses certain acts which constitute the making of a gift. Among the acts discussed is the renunciation, or attempted renunciation, of property, or a property interest, passing from a decedent. In what was intended to be the application of the rules in *Brown* v. *Routzahn* (1933) 63 F.2d 914, cert. denied 290 U.S. 641, and *Hardenbergh* v. *Commissioner* (1952) 198 F.2d 63, cert. denied 344 U.S. 836, it was stated that where title to the property did not vest in the beneficiary or heir immediately upon the decedent's death, the renunciation of the property did not constitute the making of a gift, but that where title vested in the beneficiary or heir immediately upon the decedent's death, the act of the beneficiary or heir in giving up what passed to him from the decedent constituted the making of a gift. Furthermore, in the notice the position was taken in paragraph (c) that a partial renunciation of property could not be made. Protests on these provisions were received. After reviewing these protests, we have reconsidered our position and now believe that the proper distinction between these

two court cases turns on the question of whether under the applicable State law a beneficiary or heir can or cannot refuse to accept ownership of the property which passed from the decedent. Accordingly, we have revised paragraph (c) of section 25.2511-1 to reflect this change of position. Also, we have abandoned the position that a partial renunciation cannot be made, and paragraph (c) has been further changed to recognize a partial renunciation where it is effective, as such, under local law.

Annual exclusions for gifts to minors.

In general, section 2503(b) authorizes an annual exclusion of $3,000 for gifts of present as against future interests. Section 2503(c) then provides (in part) that a gift of property to a person under 21 years of age will not be considered a gift of a future interest in property if the property "may be expended . . . for the benefit of" the donee before his attaining the age of 21 years. In the notice of proposed rule making, it was indicated by way of example that the above-quoted condition of the section might be satisfied even though the trustee or custodian of the property did not have the unrestricted discretion to determine the amount and purpose of any expenditure for the donee. This example has been modified in order to point out that the trustee or custodian must have unrestricted discretion in these respects.

Section 2503(c) further provides that in the event the donee dies before attaining the age of 21 years, the property must be payable to his estate or "as he may appoint under a general power of appointment." The position is taken in the notice that the power of appointment must be validly exercisable by the donee under the applicable local law (taking into account the fact that the donee is under 21 years of age). It is our opinion that Congress did not intend that the condition of the section relating to the power of appointment be satisfied by setting up a power of appointment in the donee that could never be used. Certainly, a literal reading of the statute sup-

ports such position, i.e., if the power was not exercisable, the property would not "be payable...as [the donee] may appoint." Furthermore, it is our understanding that the purpose of section 2503 is to allow the annual exclusion for gifts to minors when they substantially own the transferred property (because gifts to adults receive such treatment). The minors do not substantially own the transferred property if, when they die under 21 years of age, the donor can control the disposition of the property (as he can if the minor is given a nonexercisable power, with gift over in default of appointment).

Only a few protests were received which objected to the position taken in the notice regarding the power of appointment. Such protests contain two main arguments. First, it is contended that the position taken in the notice is inconsistent with Rev. Rul. 55-518, C.B. 1955-2,384, which would include in a decedent's gross estate under section 2041, the value of property over which the decedent "has at the time of his death a general power of appointment" even though such power is not exercisable because of the decedent's incompetency. It is our thought that the position in the notice is proper and that it can be reconciled with the ruling, since the language contained in section 2503(c) is different from that contained in section 2041 (see above-quoted material). However, if it should be determined that the position taken in the notice is inconsistent with Rev. Rul. 55-518, reconsideration could be given at a later time to the position in the revenue ruling, taking into account other related problems in the field of estate taxation.

Secondly, it is contended that Congress knew that persons under the age of 21 cannot generally exercise powers of appointment and that the inclusion of the power of appointment provision was intended to cover cases where minors were given nonexercisable powers. This argument does not seem convincing to us, especially since in some States powers of appointment can be exercised by persons under 21 years of age (e.g., some States allow a person 18 years of age to exercise powers of appointment).

Commissioner